

Inequality and Growth

Why in news?

Recently, researchers from the Paris School of Economics have shown inequality in modern India to be greater than colonial times.

What is the impact of inequality on democratic processes?

- **Disparity-** High levels of inequality reduce growth in relatively *poor countries but encourage growth in richer countries*.
- **Economic effect-** It can have negative effects on consumption, welfare, and growth. If done properly, wealth taxes and distribution can have positive effects.
- **Monopoly power-** Billionaires draw their wealth from monopoly. Thus, for any given level of money wages, real wages which determine purchasing power are lower in economies with strong monopolies.
- **Lower outputs-** The presence of monopolies can lead to lower real wages and lower levels of output and investment.
- **Greedflation-** A stark example is the cost-of-living crisis in developed economies, where "greedflation"—companies raising prices to boost profit margins amid supply and demand shocks—has exacerbated inflation.
- **High mark-up-** When companies apply higher mark-ups, they increase the final price that consumers pay.
- This can indeed lead to reduced purchasing power for workers, as their real wages (adjusted for inflation) may not keep pace with rising prices.

Mark up refers to the difference between the cost of producing a product or service and its selling price

- **Weak expansion-** An unequal economy will put lesser incomes in the hands of those with a greater propensity to consume, leading to weaker expansion in the economy.
- **Lower job creation-** Redistribution might hurt job creation by lowering incentives for entrepreneurs to invest and create jobs in high-tax environments.

Kuznets curve describes a U-shaped relationship between inequality and growth, inequality first increases and later decreases in the process of economic development

How can redistribution be harmonized with economic growth?

- **Welfare opportunities-** Inequality is sometimes beneficial, since it acts as an

incentive to entrepreneurs to start businesses, thereby increasing employment and welfare for others.

- **Multiplier effect**- When a company builds a new factory, it pays workers, who then spend their wages on goods, boosting sellers incomes. This cycle of spending and earning, known as the 'multiplier' effect, leads to a greater overall increase in income than the initial investment.
- **Unlocking Growth Potential**- Redistribution can boost growth despite reduced billionaire investment. It strengthens the multiplier effect by increasing purchasing power. Lower prices and higher wages from curbing monopolies further drive demand, encouraging business investment.
- **Piketty's Proposal**- Taxing billionaire wealth for basic income might lead to some leaving the economy, but it could foster new entrepreneurs.

What should be done?

- For *poor countries*, the escape from poverty is made more difficult because rising per capita income induces more inequality, which retards growth in this range.
- For *rich countries*, rising per capita income tends to reduce inequality, which lowers growth in this range.
- While inequality can incentivize entrepreneurship, excessive inequality, particularly through monopolistic practices, hampers economic welfare and growth.
- Thoughtful redistribution policies, such as wealth taxes and curbing monopolistic powers, can mitigate these negative effects and promote a more equitable and robust economy.

Quick Facts

Greedflation

- **About**- It is the exploitation of inflation by corporates to create excessive profits.
- It simply means (corporate) greed fuelled inflation.
- **Normal inflation**- The corporates go for the wage-price spiral, in Greedflation corporates choose the profit-price spiral.
- **Wage-price spiral** - A cyclical condition where the rise in wages leads to increased prices, resulting in inflation.
- **Profit-price spiral** - Companies exploit the existing inflation by putting up their prices way beyond just covering their increased costs.
- This is used to maximise their profit margins that, in turn, further fuelled inflation.
- **Occurrences**- Greedflation happens in two scenarios.
 - When the price mark-up is far in excess of the increase in inputs.
 - When businesses do not bring down the market prices even when the input prices fall.

References

1. [The Hindu| Does inequality lead to growth?](#)

2. [NBER| Inequality and growth](#)

